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DEPARTMENT FOR EUR A/S FRIED AND NCE

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SUBJECT: SCENE-SETTER FOR ASSISTANT SECRETARY FRIED'S VISIT
TO HUNGARY JULY 11 - 12

¶1. (U) Embassy Budapest warmly welcomes the visit of A/S Fried to Hungary.

SUMMER OF NO LOVE LOST

¶2. (SBU) Your trip comes at the beginning of the summer "cucumber season," and an exhausted Gyurcsany government is taking a much-needed (if not particularly well-deserved) break after a year characterized by inertia in the domestic reform agenda and drift - often toward Moscow - in foreign policy. The PM is on the defensive personally and politically: the opposition continues to press him on all fronts, and he is increasingly embattled within the coalition and isolated even within his own MSZP. Although a single rival has yet to emerge, Gyurcsany's poll numbers remain mired at 20% and his departure has become a possibility. Hungarians inside the government and out are tired of Gyurcsany's high-handed but unfocused approach, and his government is being criticized for combining the mistakes of a novice government with the exhaustion of a lame duck administration.

¶3. (SBU) This has been particularly evident in foreign affairs, where Gyurcsany's comments on key issues including Energy Security and Missile Defense have been ambiguous at best. His tendency to extemporize on foreign policy has been compounded by a dysfunctional bureaucracy and, we hear from multiple sources, the unwillingness of their embassy in Washington to report bad news. The result has been a government that often appears to be a "neutral ally."

FIDESZ: SAYING NO ... BUT MAKING EYES

¶4. (SBU) By contrast, FIDESZ is working hard to repair its relationship with us. Whether through calculation or conviction, they have aligned themselves with us on key issues. While other and more moderate voices are being heard within FIDESZ, it is still Orban's party. Although he has no immediate constitutional means to force Gyurcsany from office, he clearly senses the government's vulnerability on foreign policy and is playing the transatlantic card to the hilt. We recommend that you meet with FIDESZ representatives, both to support our active but non-partisan approach and to build multipartisan consensus on foreign policy. We're in touch with Orban's staff regarding a potential meeting, but want to be sure that the scheduling does not poison the well for your session with Gyurcsany.

GETTING ATTENTION

¶5. (SBU) Although insiders tell us the PM rarely focuses on foreign or security affairs - and then usually to view the issues through the prism of domestic political calculation - we believe we now have his attention. His first reaction (as always) has been to blame others, but the personal intervention of Tom Lantos and Charles Gati has made the PM

aware that he has a serious problem. He knows that we are looking for clear statements and clearer actions, and the challenge now will be getting him to focus on strategic rather than just tactical concerns.

GETTING RESULTS

¶6. (SBU) We believe he is making an effort to do so. The GoH has announced a slight increase in defense spending to signal their commitment to NATO and the transatlantic relationship, and the MOD has been aggressively pressing its bid to host the C-17s of NATO Strategic Airlift Consortium at Papa Air Base. Gyurcsany will travel to Russia again later this summer for a "Finno-Ugric Cultural Summit," but is considering a stop in Tallinn to offset the optics of his meeting with Putin (and the Finnish President). He made his first appearance at our July 4th reception this week as a clear signal of his desire to mend fences with us.

¶7. He has also engaged personally to contest the ongoing effort of Austria's OMV - likely fronting for Moscow - to buy out the Hungarian oil company MOL. MOL stock has skyrocketed in the past week, potentially ruining the economics of the takeover bid, but we suspect the takeover bid is motivated by more than economic advantage. The government is also considering legislation to introduce a review system for foreign acquisition of strategic industries akin to our CFIUS regulations. We are standing by to support them in this regard, and will need to increase the level and frequency of our engagement in order to match Russia's activism.

¶8. (SBU) Poland's PKN Orlen is a potential white knight, but Warsaw is extremely mistrustful of Budapest and could drive a hard bargain politically and economically re any cooperation. Significantly, the government and the opposition here are

cooperating in MOL's defense: both understand that the loss of MOL would be an irreversible defeat, and all appreciate our active engagement. We are working to arrange a meeting with MOL CEO Zsolt Hernadi and, time permitting, a session with Janos Koka, the young, intense, and Western-oriented Minister of Economy and SZDSZ party president, who has been the GoH's leading voice on Nabucco and on transparency. He has pushed Gyurcsany hard on these issues, using his small party's asymmetric leverage within the coalition to maximum effect, but has also emphasized to us the importance of "making the relationship with Gyurcsany work."

KEEPING IN TOUCH

¶9. (SBU) Gyurcsany has repeatedly appealed to us for enhanced consultations to avoid further "misperceptions." Rightly or wrongly, Hungarians perceive our level of engagement declining, and your visit - well-timed to review the Kennebunkport meetings and the way forward on Kosovo - will help ensure that they have no pretext to question our commitment or our policy.

¶10. (SBU) The PM is also taking steps to improve coordination within and without, taking on highly-regarded diplomat Karoly Banai as his Foreign Policy Advisor. (Banai has been at pains to emphasize his commitment to the transatlantic relationship, pledging to "never surprise and always deliver." He has also asked to get together with you on the margins of your one-on-one with Gyurcsany.) FM Goncz will be out of the country during your visit but has been living on borrowed time for months; many expect a change at the MFA by year's end. Speaking of changes, our contacts throughout the GoH are looking forward to Ferenc Somogyi's arrival in Washington, commenting that it ensures an embassy that "conveys guidance faithfully and reports reaction factually."

¶11. (SBU) We have confirmed appointments with Somogyi and with MFA State Secretary Laszlo Varkonyi, who holds the Americas account (and will want to focus on the bilateral relationship, Afghanistan, and Cuba), as well as a meeting with Ivan Udvardi, the MFA PolDir (who will be primarily

interested in Russia and Kosovo). We are also working to pull together a meeting with Parliamentarians from the Foreign Affairs and European Affairs committees, although the summer vacation season has depleted their ranks. At a minimum, we have you scheduled to meet with Matyas Eorsi, the SZDSZ parliamentary faction leader and chairman of the European Affairs Committee. There will be positive issues to discuss throughout your meetings, including Hungary's leadership of a PRT in Afghanistan, their participation in the NATO Training Mission in Iraq (NTM-I), and their cautious engagement to promote a democratic transition in Cuba. There will also be frequent references to what Gyurcsany calls the "evergreen issue" of the Visa Waiver Program.

SEASONAL AFFECTIVE DISORDER ... ALL YEAR-ROUND

¶12. (SBU) The high coefficient of friction has left the average Hungarian "grumbling all the way to Lake Balaton." Although the macroeconomic indicators have by and large held steady and the financial community continues to focus on the stability of the forint and the signal successes in reducing the deficit, there are serious concerns regarding both competitiveness and transparency. Hungary is also losing ground relative to its neighbors. Politically, opinion leaders tell us they are "always pessimistic ... but finally correct" in their concern over the extent of Hungary's integration into the transatlantic community, the maturity of its parties, and the flexibility of its institutions. Our challenge is to convince them that the process - and the promise - you will recall so well from the 80s and 90s has not ended. This will be a key theme of your meeting with local think-tankers and your media round table on the morning of July 12.

¶13. (U) We look forward to welcoming you in person.

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